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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 000035

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E.O. 12958: DECL: 01/03/2017

TAGS: ECON EPET ENRG PGOV I2

SUBJECT: NINEWA: BETTER SUPPLY AND MANAGEMENT REDUCE SOME BLACK MARKET FUEL PRICES

Classified By: Acting Political Counselor Rob Waller for reasons 1.4 (b ,d).

This is a Ninewa Provincial Reconstruction Team (PRT) message.

¶1. (C/REL AUS, GBR, CAN) Summary: Black market benzene and diesel prices in Mosul have fallen since August but still remain above the government price for each fuel. Increases in benzene supply, a slight seasonal reduction in benzene demand, and improved Iraqi discipline and management of fuel distribution are some of the factors contributing to the lower prices. Winter demand kept the kerosene black market price consistently high through December. The long-term solutions to meeting local demand and reducing black market profitability and corruption include increased fuel supply through imports and parity between official and world fuel prices.

Benzene and Diesel Prices Fall, Kerosene Remains High

¶2. (C/REL AUS, GBR, CAN) The average black market price for regular benzene in Mosul fell from Iraqi Dinar (ID) 925/liter (USD 0.74) in mid-August 2007 to about ID 700/liter (USD 0.56) in mid-December 2007, according to Coalition Force surveys and Oil Products Distribution Company-Northern Branch (OPDC) statistics. Mosul residents reported that over the same period the quoted government price for a liter of benzene rose from ID 350/liter (USD 0.28) to ID 500 (approx. USD 0.40). Benzene delivery from the Baiji Oil Refinery (BOR) increased at least 35 percent during the same time period.

¶3. (C/REL AUS, GBR, CAN) The average black market diesel price in Mosul fell from ID 700/liter (USD 0.56) in mid-August to ID 633/liter (USD 0.51) in mid-December, while the quoted government price stayed constant at ID 400/liter (USD 0.32). Diesel delivery decreased 18 percent during the time period.

¶4. (C/REL AUS, GBR, CAN) Kerosene prices in Mosul began in August at ID 769/liter (USD 0.62), moved up to about ID 825/liter (USD 0.66) in September and October and dropped back to only ID 700/liter in December, compared to a quoted government price increase over the same period from ID 150/liter (USD 0.12) to ID 200/liter (USD 0.16). Kerosene delivery from the BOR tripled between August and December.

¶5. (C/REL AUS, GBR, CAN) Businessmen, farmers and government officials from Mosul and outlying areas of western, southern and eastern Nineva corroborated the statistical picture of falling benzene and diesel black market prices. These PRT contacts reported that queues were shorter and black market prices were down for benzene and diesel. However, kerosene

prices and shortages remained high or increased over the same period.

Improved Iraqi Administration Stretches Meager Supply

¶6. (C/REL AUS, GBR, CAN) OPDC-Northern Branch General Manager Mohamed al Zibari, who oversees fuel distribution for northern Iraq, has worked closely since September with the Mayor of Mosul, where two-thirds of Ninewa's three million people live, to enforce discipline in the fuel distribution system. Working from an OPDC-Northern Branch schedule of deliveries, provincial officials followed up to check stations' supplies on hand and hours of operation. In November alone, 25 gas stations were closed or fined for pulling fuel out of the official system and selling it at inflated prices on the black market, al Zibari said. Al Zibari and the Mosul Mayor said they would like to replicate their enforcement system in the rest of the province.

¶7. (C/REL AUS, GBR, CAN) Al Zibari attributed some of this year's drop in the black market benzene price to increased consumer confidence as they recognized better accountability in the fuel distribution system. This increased predictability, coupled with the increased benzene supply, reduced the need for consumers to grab any available benzene at exorbitant black market prices. Alternatively, the kerosene market saw continued high prices because the increased supply from the BOR was overshadowed by Ninewa residents' increased demand for their perceived winter needs. Ninewa residents told the PRT in the fall of 2007 that they planned to stockpile kerosene at up to three times the government price, contributing to a bidding war that reinforced black market profitability.

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Businessmen Would Trade Higher Prices for More Supply

¶8. (C/REL AUS, GBR, CAN) Operating at full capacity, without restricted credit or security fears, Ninewa's economy would require 3 million liters/day of benzene, al Zibari said, based on estimates of personal and vehicle fuel usage. In the current restrictive security and economic environment, he said the province only needed slightly more than the 1.1 million liters/day of benzene that it received. As security and economic conditions improve, though, Iraqi officials would need much more benzene, diesel and kerosene, a demand Al Zibari said imports at the world price for each would have to meet.

¶9. (C/REL AUS, GBR, CAN) Business owners and investors across Ninewa told the PRT in fall 2007 that they understood how the disparity between the official and black market fuel prices encouraged corruption. They endorsed an increase in the official fuel price, with the understanding that the higher official price would attract increased private imports and reduce the black market's profitability. They acknowledged that about one-quarter of Ninewa residents relied on the current officially priced fuel, for which they might wait in line seven days. Few businesses or farmers could afford to wait so long for fuel, no matter how cheap, the Ninewa entrepreneurs said.

Comment: Increased Imports and Price Parity

¶10. (C/REL AUS, GBR, CAN) While administrative improvements at the OPDC-Northern Branch are a good sign for GOI capacity, they will not solve the underlying problems in Iraqi fuel distribution: lack of sufficient supply and disparity between black market and government prices. Iraqi refineries are unlikely in the short term to triple domestic supply, indicating that government or private imports must meet Iraqis' needs both during this winter's kerosene crunch and

as the country's improving security demands more benzene for a growing economy. If the government markets imports at the world price, it would meet the terms of the International Monetary Fund agreement with Iraq.

¶11. (SBU) Simultaneously, official Iraqi fuel prices should be allowed to match the world price, incentivizing private importers and eliminating black marketers' windfall gain. Such a policy would help eliminate black market-driven corruption and provide a more steady supply of fuel to the businesses that need it to power Nineva's economy. However, increased official fuel prices would be politically untenable unless a system, such as the Social Safety Net, continued to provide for the poorest 25 percent of society that relies on cheap fuel.

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